

2. Report of the Auditor-General

Report of the auditor-general to the Free State Legislature and the council on the Ngwathe Local Municipality

Report on the financial statements

Introduction

1. I have audited the financial statements of the Ngwathe Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South Africa Standards of Generally Recognised Accounting Practise (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act, 2003 (Act no. 56 of 2003) (MFMA) and the Division of Revenue Act, 2015 (Act No. 1 of 2015) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Opinion

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Ngwathe Local Municipality as at 30 June 2016 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and Dora.

Emphasis of matters

7. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of corresponding figures

8. As disclosed in note 43 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors discovered during 2015-16 in the financial statements of the municipality at, and for the year ended, 30 June 2015.

Material losses

9. As disclosed in note 50 to the financial statements, material electricity losses of R126 752 795 (2015: R64 106 909) were incurred by the municipality mainly due to electricity theft.

Material impairments

10. As disclosed in notes 10 and 11 to the financial statements, management provided for the impairment of consumer and other receivables of R566 444 475 (2015: R473 132 002).

Irregular expenditure

11. As disclosed in note 49 to the financial statements, the municipality incurred irregular expenditure of R60 200 348 (2015: R9 346 751) in 2015-16 due to non-compliance with supply chain management (SCM) requirements.

Fruitless and wasteful expenditure

12. As disclosed in note 48 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R74 252 491 (2015: R51 248 897) in 2015-16 due to interest and penalty charges on the late payment of suppliers.

Unauthorised expenditure

13. As disclosed in note 47 to the financial statements, the municipality incurred unauthorised expenditure of R177 095 143 (2015: R266 727 757) during 2015-16 due to expenditure that exceeded the limits provided for in the main divisions of the approved budget.

Going concern

14. Note 45 to the financial statements indicates that the municipality incurred a net loss of R141 836 468 during the year ended 30 June 2016 and, as of that date, the municipality's current liabilities exceeded its current assets by R714 672 259. In addition, the municipality owed Eskom R544 008 986 (2015: R386 211 700) and the Department of Water Affairs R63 899 036 (2015: R50 086 403) as at 30 June 2016, which was long overdue. These conditions, along with other matters set forth in note 45, indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to operate as a going concern and to meet its service delivery objectives.

Additional matter

15. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure notes

16. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion on it.

Report on other legal and regulatory requirements

17. In accordance with the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected key performance areas presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading, but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on them.

Predetermined objectives

18. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected key performance areas presented in the annual performance report of the municipality for the year ended 30 June 2016:
- Key performance area (KPA): Basic service delivery and infrastructure development on pages xx to xx
19. I evaluated the usefulness of the reported performance information to determine whether it was consistent with the planned key performance areas. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's Framework for Managing Programme Performance Information (FMPPI).
20. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
21. The material findings in respect of the selected key performance area are as follows:

KPA: Basic service delivery and infrastructure development

Usefulness of reported performance information

22. The FMPPI requires performance targets to be specific in clearly identifying the nature and required level of performance, and measurable. A total of 66% of the targets were not specific and 83% of the targets were not measurable.
23. The FMPPI requires performance indicators to be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use. A total of 76% of the indicators were not well defined.
24. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 83% of the indicators were not verifiable.

Reliability of reported performance information

25. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was because of limitations placed on the scope of my work due to the absence of proper systems and processes and the auditee not providing sufficient appropriate evidence in support of the reported performance information. The auditee's records also did not permit the application of alternative audit procedures.

Additional matters

26. I draw attention to the following matters:

Achievement of planned targets

27. Refer to the annual performance report on pages xx to xx for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected key performance area reported in paragraphs 22 to 25 of this report.

Compliance with legislation

28. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance management

29. The integrated development plan was not drafted by taking into account the integrated development process and proposals submitted by the district municipality as required by section 29(3)(b) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (Municipal Systems Act).
30. The key performance indicators set by the municipality did not include indicators on the percentage of households with access to a basic level of water, sanitation, electricity and solid waste removal as required by section 43(2) of the Municipal Systems Act and the municipal planning and performance management regulation 10(a).

Financial statements, performance and annual reports

31. The annual performance report for 2015-16 did not include the performance of the external services providers, a comparison of the performance with the previous financial year and measures taken to improve performance as required by section 46(1)(a), (b) and (c) of the Municipal Systems Act.
32. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of non-current assets, current assets, non-current liabilities and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.

33. The 2014-15 annual report was not tabled in the municipal council within seven months after the end of the financial year, as required by section 127(2) of the MFMA.
34. The council failed to adopt an oversight report containing the council's comments on the annual report within the prescribed timelines, as required by section 129(1) of the MFMA.

Procurement and contract management

35. Goods and services with a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).

Expenditure management

36. Reasonable steps were not taken to prevent unauthorised expenditure, as required by section 62(1)(d) of the MFMA.
37. Reasonable steps were not taken to prevent irregular expenditure, as required by section 62(1)(d) of the MFMA.
38. Reasonable steps were not taken to prevent fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.
39. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.

Consequence management

40. Unauthorised expenditure by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(a) of the MFMA.
41. Irregular expenditure by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(b) of the MFMA and municipal budget and reporting regulation 75(1).
42. Fruitless and wasteful expenditure by the municipality was not investigated to determine whether any person was liable for the expenditure, as required by section 32(2)(b) of the MFMA and municipal budget and reporting regulation 75(1).

Internal control

43. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

44. Leadership did not always take prompt and adequate action to address weaknesses in performance management, which resulted in non-compliance with applicable legislation. Management failed to properly analyse the control weaknesses and implement appropriate follow-up actions that adequately addressed the root cause.

Financial and performance management

45. Management did not implement proper record keeping and prepare regular, accurate and complete performance reports that were supported and evidenced by reliable information. This was due to the lack of competent staff in the performance information division. The municipality also did not prioritise the review and monitoring of compliance with legislation, which resulted in repeat findings being reported.
46. The financial statements were not properly reviewed for completeness and accuracy prior to submission for auditing. Audit findings communicated to the municipality during the audit were corrected by management, which resulted in material adjustments to the financial statements.
47. Due to the lack of capacity, the finance division relied heavily on the use of consultants, which is not sustainable in the long term.

Governance

48. The municipality did not promptly initiate steps based on the risk assessment performed to address risks relating to the performance management system.

Bloemfontein

30 November 2016



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence